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Illinois Independent Telephone Association	)	
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Petition for initiation of an investigation of the	)	
necessity of and the establishment of a	)	Docket No. 00-0233
Universal Service Support fund in	)	
accordance with Section 13-301(d) of	)	
The Public Utilities Act.	)	Cons.
 Illinois Commerce Commission	)	
On Its Own Motion	)	
	)	Docket No. 00-0335
Investigation into the necessity of and,	)	
if appropriate, the establishment of an universal	)	
support fund pursuant to Section 13-301(d)	)	
of the Public Utilities Act.	)	

INITIAL BRIEF OF

GRAFTON TELEPHONE COMPANY,  
GRIDLEY TELEPHONE COMPANY,  
HARRISONVILLE TELEPHONE COMPANY,  
HOME TELEPHONE COMPANY,  
METAMORA TELEPHONE COMPANY, and  
TONICA TELEPHONE COMPANY

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### SUMMARY

This is a case of first impression before the Illinois Commerce Commission interpreting and implementing a new State statute. The record shows that each of the Companies qualifies under Section 13-301(d) of the Public Utilities Act for State universal service support. Each Company presently receives funding pursuant to the Commission's Orders referenced in Section 13-301(d). Each Company's economic costs of providing services for which universal service support may be made available exceed the affordable rate for such services less federal universal service support received by the Company with respect to such services. The record contains evidence designed to identify implicit subsidies in access charges, if any, for each Company. Each Company also presented evidence to show that it is not overearning.

Each Company has shown a need for annual State universal service support based on a proper ROR earnings analysis.<sup>1</sup> The Company are requesting funding based on their rate of return ("ROR") earnings analysis. The ICC Staff clarified its position on cross examination to indicate that individual company funding based on the ROR analysis was appropriate to avoid significant adverse impacts on subscribers (at least for the first year so a further review could be conducted by the Staff), and the Hearing Examiner and Commission relied heavily on this position by the Staff in finding that four of the Companies were not prejudiced by the striking of their embedded cost studies and the denial of their Petition for Interlocutory Review. Senator Frank Watson presented testimony opposing any action by the Commission that would have adverse impacts on subscribers, such as

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<sup>1</sup> The Companies' demonstrated needs are: Tonica \$56,398, Metamora \$354,556, Grafton \$205,912, Gridley \$514,219, Harrisonville \$1,064,529, and Home Telephone \$633,541.

the projected \$78 per month rate for basic local telephone service that would have to be charged by Home Telephone Company.

The Companies' existing rates are the affordable rates for purposes of Section 13-301(d) based upon the totality of the evidence in the record and based upon the failure of any other party or the Commission Staff to present sufficient evidence to overcome the statutory presumption that the existing rates are the affordable rates.

To the extent that HAI is to be used at all, the inputs utilized by IITA and Mr. Petrouske on behalf of Home Telephone are the most appropriate inputs. The record clearly shows that these inputs are well supported and that the ICC Staff and AT&T witnesses who opposed them have absolutely no experience or expertise in matters relating to small telephone companies.

The proper interpretation of the term "economic costs" in Section 13-301(d) allows for the use and consideration of embedded cost analysis, especially in light of the provision of the section that says "proxy costs" may be used. In fact, if not for the language permitting use of "proxy costs," a proper application of the rules of statutory construction would suggest that the term "economic costs" means embedded costs. In light of the FCC's recent Order in CC Docket 96-45 which specifically found that "it is **not possible** to determine the forward-looking costs of rural carriers at this time,"<sup>2</sup> the Commission should as a matter of policy determine that embedded costs is the

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<sup>2</sup> While other parties may argue that the FCC was considering its Synthesis Model, and that the FCC's statement about it **not being possible** to determine forward looking costs for rural carriers at this time should be seen as limited to that model, the record in this case is clear that the FCC was aware of the HAI model and that it had considered the HAI model and that the Synthesis model is very similar to the HAI model. IITA Ex. 2.0, pp. 21, AT&T Ex. 4.0, pp. 10-11 and Transcript p. 628-630. In fact, the FCC's Order specifically refers to the HAI model in

appropriate method to use for funding at this time. The Companies' ROR analysis are based on embedded costs and should be used for determining eligibility and funding.

## I. THE APPLICABLE STATUTES AND SMALL, RURAL COMPANY REGULATION

### A. The New State USF Statute

This is a case of first impression before the Illinois Commerce Commission interpreting and implementing a new State statute. Public Act 91-636 amended Section 13-301 of the Public Utilities Act by creating new subsections (d) and (e) to address the establishment of universal service support funds. The new statute divides the consideration of universal service support funds into two categories. Subsection (d) addresses a fund for small telephone companies and subsection (e) addresses a fund for any other telephone companies requiring universal service support. Section 13-301(d) reads as follows:

#### 5/13-301. Duties of the Commission

Section 13-301. **Consistent with the findings and policy** established in paragraph (a) of **Section 13-102** and paragraph (a) of **Section 13-103**, and **in order to ensure the attainment of such policies, the Commission shall:**

\* \* \*

(d) investigate the necessity of and, if appropriate, establish a universal service support fund from which local exchange telecommunications carriers **who** pursuant to the Twenty-Seventh Interim Order of the Commission in Docket No. 83-0142 or the orders of the Commission in Docket No. 97-0621 and Docket No. 98-0679 **received funding** and whose **economic costs of providing services** for which universal service support may be made available exceed the **affordable rate** established by the Commission for such services may be eligible to receive support, less any **federal universal service support** received for the same or similar costs of

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footnote 411 on page 69.

providing the supported services; provided, however, that if a universal service support fund is established, the Commission shall require that all costs of the fund be recovered from all local exchange and interexchange telecommunications carriers certificated in Illinois on a competitively neutral and nondiscriminatory basis. In establishing any such universal service support fund, the Commission shall, in addition to the determination of **costs for supported services**, consider and make findings pursuant to paragraphs (1), (2), and (4) of item (e) of this Section. **Proxy cost, as determined by the Commission, may be used for this purpose.** In determining cost recovery for any universal service support fund, the Commission shall not permit recovery of such costs from another certificated carrier for any service purchased and used solely as an input to a service provided to such certificated carrier's retail customers; ... (Emphasis Added).

Subsection (d) incorporates by reference certain provisions of subsection (e). Those provisions read as follows:

(1) Define the **group of services** to be declared "supported telecommunications services" **that constitute "universal service"**. This group of services shall, at a minimum, include those services as defined by the Federal Communications Commission and as from time to time amended. In addition, the Commission shall consider the range of services currently offered by telecommunications carriers offering local exchange telecommunications service, the existing rate structures for the supported telecommunications services, and the telecommunications needs of Illinois consumers in determining the supported telecommunications services. The Commission shall, from time to time or upon request, review and, if appropriate, revise the group of Illinois supported telecommunications services and the terms of the fund to reflect changes or enhancements in telecommunications needs, technologies, and available services.

(2) Identify all **implicit subsidies** contained in rates or charges of incumbent local exchange carriers, including all subsidies in interexchange access charges, and determine how such subsidies can be made explicit by the creation of the fund.

(4) Establish an **affordable price** for the supported telecommunications services for the respective incumbent local exchange carrier. The affordable price shall be no less than the rates in effect at the time the Commission creates a fund pursuant to this item. The Commission may establish and utilize indices or models for updating the affordable price for supported telecommunications services.

Section 13-301 also incorporates by reference the findings and policies of the Illinois General Assembly from Section 13-102(a) and Section 13-103(a) and specifically provides that **in order to ensure the attainment of such policies**, the Commission shall investigate the necessity of and, if appropriate, establish a universal service support fund. Section 13-102(a) reads as follows:

Section 13-102. Findings. With respect to telecommunications services, as herein defined, the General Assembly finds that:

(a) universally available and widely affordable telecommunications services are essential to the health, welfare and prosperity of all Illinois citizens;

Section 13-103(a) reads as follows:

Section 13-103. Policy. Consistent with its findings, the General Assembly declares that it is the policy of the State of Illinois that:

(a) telecommunications services should be available to all Illinois citizens at just, reasonable, and affordable rates and that such services should be provided as widely and economically as possible in sufficient variety, quality, quantity and reliability to satisfy the public interest;

The implementation of the new State statute (Section 13-301(d)) must be done in a manner consistent with the findings and policies of the Illinois General Assembly in Sections 13-102(a) and 13-103(a) **to ensure** that telecommunications services will be made available to all Illinois citizens at just, reasonable, and affordable rates and that such services will be provided as widely and economically as possible in sufficient variety, quality, quantity and reliability to satisfy the public interest. Likewise, any undefined term in Section 13-301(d) must be interpreted consistent with such policy.

**B. Section 254 of the Federal Telecommunications Act**

Since the new State statute is intended to foster universal service, this proceeding cannot be

conducted without recognizing the national policies in the federal Telecommunications Act of 1996, 47 U.S.C. 254, and the rules and Orders of the FCC implementing the universal service provisions of that Act. As relevant to the issues in this proceeding affecting the Companies, Section 254 regarding universal service provides as follows:

(b) UNIVERSAL SERVICE PRINCIPLES.--The Joint Board and the Commission shall base policies for the preservation and advancement of universal service on the following principles:

(1) QUALITY AND RATES.--Quality services should be available at just, reasonable, and affordable rates.

\* \* \*

(3) ACCESS IN RURAL AND HIGH COST AREAS.--Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have **access to telecommunications and information services**, including interexchange services and advanced telecommunications and information services, that are **reasonably comparable** to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.

\* \* \*

(5) SPECIFIC AND PREDICTABLE SUPPORT MECHANISMS.--There should be **specific, predictable and sufficient** Federal and State mechanisms to preserve and advance universal service.

\* \* \*

(f) STATE AUTHORITY.--A State may adopt regulations **not inconsistent with the Commission's rules to preserve and advance universal service**. Every telecommunications carrier that provides intrastate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State. **A State may adopt regulations to provide for additional definitions and standards to preserve and advance universal service within that State only to the extent that such regulations adopt additional specific, predictable, and sufficient mechanisms to support such definitions or standards that do not rely on or burden Federal universal service support mechanisms.**



The implementation of Section 13-301(d) must be done in a manner consistent with Section 254 of the federal Telecommunications Act of 1996, such that subscribers in rural, insular, and high cost areas have access to telecommunications and information services, including advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas. Sections 13-301(d) must also be implemented and any undefined term or ambiguous provision must be interpreted to provide a specific, predictable and sufficient State mechanisms to preserve and advance universal service.

**C. The Regulatory Scheme for Small Telephone Companies**

Since 1986, small telephone companies in the State of Illinois have been subject to only limited regulation under the Public Utilities Act. In 1986, the Act was amended by the creation of a new Article 13 to address telecommunications carriers. Article 13 contains a number of provisions limiting the regulatory burdens on small telephone companies. Paramount in this regard is Section 13-504 of the Act.

Section 13-504 specifically makes the ratemaking provisions of Article IX of the Act inapplicable to local exchange carriers with 35,000 or fewer subscriber access lines. The Commission's only ratemaking authority with respect to such small companies is Section 13-504. Unlike tariff filings by larger companies, tariff filings by small companies cannot be suspended during any ICC investigation, and no such investigation is authorized unless a petition or complaint is filed by the appropriate number the company's customers. Section 13-504 also provides for exemptions for small companies from other requirements of the Act.

This proceeding was not initiated by the petition or complaint of a sufficient number of the Companies' customers, and therefore cannot be considered a ratemaking proceeding under Section 13-504 or Section 5-25 of the Illinois Administrative Procedures Act, 5 ILCS 100/1-1 et seq. ("IAPA"). This proceeding is also not a proper "contested case" under the IAPA because the individual small telephone companies whose rights and livelihood are at stake herein were not specifically made parties to either the IITA's petition in docket 00-0233 or the Commission's order initiating docket 00-0335. Furthermore, the notice sent to all telecommunications carriers in the State by the ICC Chief Clerk when the docket 00-0335 was initiated did not comply with Section 10-25 of the IAPA, 5 ILCS 100/10-25. Finally, this proceeding is not a proper request for a declaratory ruling under Section 200.220 of the Commission's Rules of Practice, 83 Ill. Adm. Code 200.220 and Section 5-150 of the IAPA, 5 ILCS 100/5-150, because it was not requested by an "affected party" and was not captioned as such. This proceeding is only an investigation.

The implementation of the new State statute (Section 13-301(d)) must be done in a manner consistent with the policies of the Illinois General Assembly in Section 13-504 with respect to the statutory scheme for limited regulation of small telephone companies. Likewise, any undefined term in Section 13-301(d) must be interpreted consistent with such policy.

## **II. THE COMPANIES EACH QUALIFY FOR IUSF SUPPORT**

### **A. Tonica Telephone Company**

The record shows that Tonica Telephone Company presently receives funding pursuant to the Commission's Twenty-Seventh Interim Order in Docket No. 83-0142. IITA Ex. 2, Attachment

1. The record shows that the Company's economic costs of providing services for which universal service support may be made available exceed the affordable rate for such services less federal universal service support received by the Company with respect to such services. Tonica Ex. 1, Schedule 1.01 and IITA Ex. 2, Attachment 5. The record contains evidence designed to identify implicit subsidies in access charges, if any. IITA Ex. 2, Attachment 6. The record also contains evidence to address the Commission's concern about the level of earnings by the small companies. The Company presented evidence to show that it is not overearning. Tonica Ex. 1, Schedule 1.01. This evidence also shows that the Company's requested amount of State universal service support will not cause it to be overearning. Id. Therefore, the Company is eligible and has a need for State universal service support under Section 13-301(d) of the Public Utilities Act.

The affordable rate for basic local exchange telecommunications service in the Company's service area is the Company's existing rate of \$38.29. IITA Ex. 4.0, Attachment 8. This amount includes all charges and taxes that a subscriber of the Company must pay in order to have access to basic local exchange service. For purposes of determining eligibility for State universal service support funding, the Company's affordable rate (including only the local charge and the state SLC) is \$31.20.<sup>3</sup> IITA Ex.2, Attachment 5, line 51. The Company's current rate is above the various affordable rates proposed by the parties to this proceeding and the ICC Staff, therefore pursuant to the statute the Company's existing rate is the affordable rate. 220 ILCS 5/13-301(e)(4).

The Company's costs of providing basic local exchange services or its "economic costs" are

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<sup>3</sup> This amount represents a weighted average rate.

shown in three different ways in the record. The Company's rate of return ("ROR") earnings analysis, which may be considered a "proxy" under the statute, shows a funding deficiency of \$55,036. Tonica Ex. 1, p. 6 & Schedule 1.01. The IITA has explained the inherent difficulties in accepting the results of the HAI model on an individual small company basis, and therefore has proposed using the weighted average cost for the combined group of small companies as a "proxy." IITA Ex. 2, pp. 13-15 and 44. The small companies as a group have economic costs exceeding their affordable rate and federal funding under the weighted average proxy cost approach. IITA Ex. 2, p. 46 and IITA Ex. 2, Attachment 5, line 57. Finally, even if the HAI model results for the Company are considered on an individual basis, the evidence shows a need of \$252,121 for the Company. IITA Ex. 2, Attachment 5, line 51. Thus, the Company qualifies for State universal service support under each of the proposed methodologies in the record for determining economic costs, eligibility and funding. Tonica therefore takes no position at this time on the correct interpretation of the undefined term "economic cost" in the statute.

The Company's federal universal service support received for the same or similar costs of providing the supported services is identified and subtracted out of the Company's ROR analysis, and the HAI analysis presented by IITA (whether considered in the aggregate with the group of small companies as a "proxy" or on an individual company basis). Tonica Ex. 1, Schedule 1.01 and IITA Ex 2, Attachment 5.

Tonica Telephone Company has shown a need for annual State universal service support in

the amount of **\$56,398** based on a proper ROR earnings analysis.<sup>4</sup> IITA Ex. 4, Attachment 10, 2nd Revised, line 54. **The Company is requesting funding in this amount.** No party or ICC Staff witness challenged the ROR analysis presented by the Company, and the Company's witness was not cross examined. Based upon its ROR analysis and its affordable rate, the Company has a need for and qualifies for State universal service support in said amount.

**B. Metamora Telephone Company**

The record shows that Metamora Telephone Company presently receives funding pursuant to the Commission's Twenty-Seventh Interim Order in Docket No. 83-0142. IITA Ex. 2, Attachment 1. The record shows that the Company's economic costs of providing services for which universal service support may be made available exceed the affordable rate for such services less federal universal service support received by the Company with respect to such services. IITA Ex. 2, Attachment 5. The record contains evidence designed to identify implicit subsidies in access charges, if any. IITA Ex. 2, Attachment 6. The record also contains evidence to address the Commission's concern about the level of earnings by the small companies. The Company presented evidence to show that it is not overearning. Metamora Ex. 1, Schedule 1.01. This evidence also shows that the Company's requested amount of State universal service support will not cause it to be overearning. Id. Therefore, the Company is eligible and has a need for State universal service

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<sup>4</sup> This amount reflects the adjustment for changes in federal universal support discussed by ICC Staff witnesses Voss and Smith and IITA witness Schoonmaker in their rebuttal testimony. See ICC Staff Ex. 16.0, Schedule 16.17. The ICC Staff and IITA are in agreement on the amount of the adjustment and the Company hereby accepts the results of the adjustment.

support under Section 13-301(d) of the Public Utilities Act.

The affordable rate for basic local exchange telecommunications service in the Company's service area is the Company's existing rate of \$28.67. IITA Ex. 4.0, Attachment 8. This amount includes all charges and taxes that a subscriber of the Company must pay in order to have access to basic local exchange service. For purposes of determining eligibility for State universal service support funding, the Company's affordable rate (including only the local charge and the state SLC) is \$21.51.<sup>5</sup> IITA Ex.2, Attachment 5, line 41. The Company's current rate is below the affordable rates proposed by the ICC Staff, Verizon and WorldCom, and above the affordable rates calculated using the methodologies presented by Harrisonville and the IITA. The affordable rate issue is addressed for all of the Companies later in this Brief. It is the Company's position that its existing rate is the affordable rate.

The Company's costs of providing basic local exchange services or its "economic costs" are shown in three different ways in the record. The Company's rate of return ("ROR") earnings analysis, which may be considered a "proxy" under the statute, shows a funding deficiency of \$354,556. Metamora Ex. 1, p. 4 & Schedule 1.01. The IITA has explained the inherent difficulties in accepting the results of the HAI model on an individual small company basis, and therefore has proposed using the weighted average cost for the combined group of small companies as a "proxy." IITA Ex. 2, pp. 13-15 and 44. The small companies as a group have economic costs exceeding their affordable rate and federal funding under the weighted average proxy cost approach. IITA Ex. 2,

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<sup>5</sup>. This amount represents a weighted average rate.

p. 46 & Attachment 5, line 57. Finally, even if the HAI model results for the Company are considered on an individual basis, the evidence shows a need of \$1,433,917 for the Company. IITA Ex. 2, Attachment 5, line 41. Thus, the Company qualifies for State universal service support under each of the proposed methodologies in the record for determining economic costs, eligibility and funding. Metamora therefore takes no position at this time on the correct interpretation of the undefined term “economic cost” in the statute.

The Company’s federal universal service support received for the same or similar costs of providing the supported services is identified and subtracted out of the Company’s ROR analysis, and the HAI analysis presented by IITA (whether considered in the aggregate with the group of small companies as a “proxy” or on an individual company basis). Metamora Ex. 1, Schedule 1.01 and IITA Ex 2, Attachment 5.

Metamora Telephone Company has shown a need for annual State universal service support in the amount of **\$354,556** based on a proper ROR earnings analysis. Metamora Ex. 1, p. 4 & Schedule 1.01. and IITA Ex. 4, Attachment 10, 2nd Revised, line 44. **The Company is requesting funding in this amount.** No party or ICC Staff witness challenged the ROR analysis presented by the Company,<sup>6</sup> and the Company’s witness was not cross examined. Based upon its ROR analysis and its affordable rate, the Company has a need for and qualifies for State universal service support in said amount.

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<sup>6</sup> There was a proposed change in the amount of funding for the Company proposed by the ICC Staff based on the amounts of federal universal support as discussed by ICC Staff witnesses Voss and Smith, however following rebuttal testimony by IITA witness Schoonmaker the Staff’s proposed change was withdrawn. See ICC Staff Ex. 16.0, Schedule 16.08.

**C. Grafton Telephone Company**

The record shows that Grafton Telephone Company presently receives funding pursuant to the Commission's Twenty-Seventh Interim Order in Docket No. 83-0142 and the orders of the Commission in Docket No. 97-0621 and Docket No. 98-0679. IITA Ex. 2, Attachments 1 and 2. The record shows that the Company's economic costs of providing services for which universal service support may be made available exceed the affordable rate for such services less federal universal service support received by the Company with respect to such services. IITA Ex. 2, Attachment 5. The record contains evidence designed to identify implicit subsidies in access charges, if any. IITA Ex. 2, Attachment 6. The record also contains evidence to address the Commission's concern about the level of earnings by the small companies. The Company presented evidence to show that it is not overearning. Grafton Ex. 1, Schedule 1.01. This evidence also shows that the Company's requested amount of State universal service support will not cause it to be overearning. Id. Therefore, the Company is eligible and has a need for State universal service support under Section 13-301(d) of the Public Utilities Act.

The affordable rate for basic local exchange telecommunications service in the Company's service area is the Company's existing rate of \$30.06. IITA Ex. 4.0, Attachment 8. This amount includes all charges and taxes that a subscriber of the Company must pay in order to have access to basic local exchange service. For purposes of determining eligibility for State universal service support funding, the Company's affordable rate (including only the local charge and the state SLC)



is \$19.61.<sup>7</sup> IITA Ex.2, Attachment 5, line 26. The Company's current rate is below the affordable rates proposed by the ICC Staff, Verizon and WorldCom, and above the affordable rates calculated using the methodologies presented by Harrisonville and the IITA. The affordable rate issue is addressed for all of the Companies later in this Brief. It is the Company's position that its existing rate is the affordable rate.

The Company's costs of providing basic local exchange services or its "economic costs" are shown in three different ways in the record, and a fourth manner of looking at its costs based on an embedded cost analysis was offered but not admitted into the record. The testimony including the embedded cost analysis was accepted as an Offer of Proof. The Company's rate of return ("ROR") earnings analysis, which may be considered a "proxy" under the statute, shows a funding deficiency of \$223,441. Grafton Ex. 1, pp. 5, 7 & Schedule 1.01. The IITA has explained the inherent difficulties in accepting the results of the HAI model on an individual small company basis, and therefore has proposed using the weighted average cost for the combined group of small companies as a "proxy." IITA Ex. 2, pp. 13-15 and 44. The small companies as a group have economic costs exceeding their affordable rate and federal funding under the weighted average proxy cost approach. IITA Ex. 2, p. 46 and IITA Ex. 2, Attachment 5, line 57. Even if the HAI model results for the Company are considered on an individual basis, which the Company opposes, the evidence shows a need of \$184,394 for the Company. IITA Ex. 2, Attachment 5, line 26. The embedded cost analysis offered by the Company but not admitted shows a need of \$145,440. Grafton Ex. 3.0, p.

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<sup>7</sup> This amount represents a weighted average rate.

11 & Schedule 3.01 (O of P) and Grafton Ex. 4.0, p. 5 (O of P). Thus, the Company qualifies for State universal service support under each of the proposed methodologies in the record (and the embedded cost analysis which was offered but not admitted) for determining economic costs, eligibility and funding. Grafton's position on the correct interpretation of the undefined term "economic cost" in the statute and the correct method to use for determining economic costs, eligibility and funding is addressed later in this Brief.

The Company's federal universal service support received for the same or similar costs of providing the supported services is identified and subtracted out of the Company's ROR analysis, the HAI analysis presented by IITA (whether considered in the aggregate with the group of small companies as a "proxy" on an individual company basis) and the embedded cost analysis which was offered by the Company but not admitted. Grafton Ex. 1, Schedule 1.01, IITA Ex 2, Attachment 5, and Grafton Ex. 3, Schedule 3.01(O of P).

Grafton Telephone Company has shown a need for annual State universal service support in the amount of **\$205,912** based on a proper ROR earnings analysis.<sup>8</sup> IITA Ex. 4, Attachment 10, 2nd Revised, line 29. The Company is requesting funding in this amount. No party or ICC Staff witness challenged the ROR analysis presented by the Company, and the Company's witness was

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<sup>8</sup> This amount reflects the adjustment for changes in federal universal support discussed by ICC Staff witnesses Voss and Smith and IITA witness Schoonmaker in their rebuttal testimony. See ICC Staff Ex. 15.0, Schedule 15.17. The ICC Staff and IITA are in agreement on the amount of the adjustment and the Company hereby accepts the results of the adjustment.

not cross examined. Based upon its ROR analysis and its affordable rate, the Company has a need for and qualifies for State universal service support in said amount.

**D. Gridley Telephone Company**

**1. The Company is Eligible for IUSF Support**

The record shows that Gridley Telephone Company presently receives funding pursuant to the Commission's Twenty-Seventh Interim Order in Docket No. 83-0142 and the orders of the Commission in Docket No. 97-0621 and Docket No. 98-0679. IITA Ex. 2, Attachments 1 and 2. The record also shows that the Company's economic costs of providing services for which universal service support may be made available exceed the affordable rate for such services less federal universal service support received by the Company with respect to such services. IITA Ex. 2, Attachment 5. The record contains evidence designed to identify implicit subsidies in access charges, if any. IITA Ex. 2, Attachment 6. The record also contains evidence to address the Commission's concern about the level of earnings by the small companies. The Company presented evidence to show that it is not overearning. Gridley Ex. 1, Schedule 1.01 and Gridley Ex. 4, Schedule 4.01 This evidence also shows that the Company's requested amount of State universal service support will not cause it to be overearning. Id. Therefore, the Company is eligible and has a need for State universal service support under Section 13-301(d) of the Public Utilities Act.

The affordable rates for basic local exchange telecommunications service in the Company's service area is the Company's existing rates which range between \$28.87 and 33.55.<sup>9</sup> Gridley Ex.

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<sup>9</sup> The weighted average rate for Gridley is \$30.07. IITA Ex. 4.0, Attachment 8.

4.0, p. 9 and Gridley Ex. 6.0, Schedule 6.01. These amounts includes all charges and taxes that subscribers of the Company must pay in order to have access to basic local exchange service. For purposes of determining eligibility for State universal service support funding, the Company's affordable rate (including only the local charge and the state SLC) is \$21.90.<sup>10</sup> IITA Ex.2, Attachment 5, line 28. The Company's current rate is below the affordable rates proposed by the ICC Staff, Verizon and WorldCom, and above the affordable rates calculated using the methodologies presented by Harrisonville and the IITA. The affordable rate issue is addressed for all of the Companies later in this Brief. It is the Company's position that its existing rates are the affordable rates.

The Company's costs of providing basic local exchange services or its "economic costs" are shown in four different ways in the record, including the embedded cost analysis by the Company's witness, M. Petrouske, which was offered but not admitted into the record, but the results of which were admitted into the record in the Rebuttal Testimony of the Company's witness, W. Flesch. The testimony of M. Petrouske and the actual embedded cost analysis were accepted as an Offer of Proof.

The Company's rate of return ("ROR") earnings analysis, which may be considered a "proxy" under the statute, shows a funding deficiency of \$622,955. Gridley Ex. 1, pp. 4, 9 & Schedule 1.01. This amount was revised to show a funding deficiency of \$514,219 in Mr. Flesch's Rebuttal Testimony. Gridley Ex. 4.0, pp. 9, 13-14 & Schedule 4.01. The IITA has explained the inherent difficulties in accepting the results of the HAI model on an individual small company basis,

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<sup>10</sup> This amount represents a weighted average rate. The breakdown of this rate is \$21.45 for residential lines and \$22.95 for business lines. Gridley Ex. 6.0, Schedule 6.01.

and therefore has proposed using the weighted average cost for the combined group of small companies as a “proxy.” IITA Ex. 2, pp. 13-15 and 44. The small companies as a group have economic costs exceeding their affordable rate and federal funding under the weighted average proxy cost approach. IITA Ex. 2, p. 46 and IITA Ex. 2, Attachment 5, line 57. Even if the HAI model results for the Company are considered on an individual basis, which the Company opposes, the evidence shows a need of \$322,221 for the Company. IITA Ex. 2, Attachment 5, line 28. The Company’s embedded cost analysis shows a need of \$624,430. Gridley Ex. 4.0 (Rebuttal Testimony of W. Flesch), p. 13 and Gridley Ex. 8.0, pp. 12, 15 & Schedule 8.01 (O of P). Thus, the Company qualifies for State universal service support under each of the proposed methodologies in the record (including the embedded cost analysis) for determining economic costs, eligibility and funding. Gridley’s position on the correct interpretation of the undefined term “economic cost” in the statute and the correct method to use for determining economic costs, eligibility and funding is addressed later in this Brief.

The Company’s federal universal service support received for the same or similar costs of providing the supported services is identified and subtracted out of the Company’s ROR analysis, the HAI analysis presented by IITA (whether considered in the aggregate with the group of small companies as a “proxy” or on an individual company basis) and the embedded cost analysis which was offered by the Company but not admitted. Gridley Ex. 1, Schedule 1.01, Gridley Ex. 4.0, Schedule 4.01 and IITA Ex 2, Attachment 5, and Gridley Ex. 8.0, Schedule 8.01(O of P).

Gridley Telephone Company has shown a need for annual State universal service support in the amount of **\$514,219** based on a proper ROR earnings analysis. Gridley Ex. 4.0, pp. 9, 13-14 &

Schedule 4.01 and IITA Ex. 4, Attachment 10, 2nd Revised, line 31. **The Company is requesting funding in this amount.** While the ICC Staff presented the testimony challenging a pro forma revenue adjustment in the Company's ROR analysis based on a concern about providing USF support for "special access" services, the Company's witness, Mr. W. Flesch, explained in his rebuttal testimony why this concern is misplaced, and he was not cross examined by the ICC Staff on this or any other matter. The justification for the Company's pro forma adjustment to intrastate access revenues is addressed in more detail below. No witness sponsored by any other party challenged the ROR analysis presented by the Company, and the Company's witness was not cross examined by any party. Based upon its ROR analysis and its affordable rate, the Company has a need for and qualifies for State universal service support in said amount.

## **2. Staff's Concern with Gridley's Adjustment Is Misplaced**

The Company made four adjustments in its ROR analysis to the 2000 earnings levels. The staff has agreed to the adjustments for IUSF, DEM, RTB Class B stock and Federal High Cost Loop Fund (HCLF) support. ICC Staff Ex. 15, Schedule 15.18. The Company also adjusted total year 2000 operating revenues for the state access rate changes that occurred July 3, 2001 due to the state mandated mirroring of interstate access rates. Gridley Ex. 1, p. 6-8, Gridley Ex. 2, Schedules 2.01 and 2.02, Gridley Ex. 4.0, pp. 5-7 and Gridley Ex. 5, Schedules 5.01 and 5.02. This adjustment is consistent with Adjustment #2 – Normalization for Approved Regulatory Changes in IITA Exhibit #3, Attachment #3 of Mr. Schoonmaker's Supplemental Direct Testimony. Id. The purpose of this adjustment is to reflect the result of the Company's July 3, 2001 state intrastate access filing on the

Company's annual revenues. Id. Effective July 3, 2001, the Company filed revised interstate access rates with the FCC. Id.

The level of intrastate special access revenues the Company received in 2000 versus what it will receive in 2001 is due to the inherent timing differences under the ratemaking methodology in the FCC's rules for historical filers. 47 CFR Part 61.39 and Transcript pp. 401-403. Thus, due to the timing differences, the higher level of 2000 intrastate access revenues will mask the need of the Company for State universal service support in subsequent periods. In other words, the revenues from intrastate access in 2000 provided a subsidy to the supported local services.<sup>11</sup> That subsidy has been removed as of July 3, 2001 when the Company was required to file new intrastate access charges which will produce lower levels of intrastate access revenue. The Commission should recognize the "real world" effects of the intrastate access charge filing.

Current state access rules require that the Company mirror its interstate rates and rate structures, subject to certain ICC defined differences for carrier common line and local switching rates, in the intrastate jurisdiction. ICC Docket 83-0142 (4th Interim Order). The Company filed intrastate access rates with the ICC to mirror the revised interstate access rates with an effective date of July 3, 2001. The impact on the Company of the state filing is an annual reduction in state

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<sup>11</sup> The fact that the Company still requires its requested level of universal service support (without regard to Staff's special access issue) can be clearly shown by the Company's embedded cost study which separated out special access and all other non-supported services and still showed a need for universal service support in excess of the Company's requested level of funding. While the Company's embedded cost study was denied admittance into the record, the results of the study were clearly presented in Mr. Flesch's Rebuttal Testimony, Gridley Ex. 4.0, p. 13, and no party moved to strike or otherwise objected to the admission of his rebuttal testimony into the record. It was admitted without objection. Transcript p. 309.

switched and special access revenue in the amount of \$251,223. Gridley Ex. 5, Schedule 5.01. This difference arises from the fact that the State access revenues in 2000 were generated by applying rates based on average 1997 and 1998 interstate revenue requirements and demand (See 47 CFR Part 61.39) to year 2000 intrastate demand. The revenues generated after July 3, 2001, will be generated by applying rates based on average 1999 and 2000 interstate revenue requirements and demand (See 47 CFR Part 61.39) to current intrastate demand. This methodology is required for Illinois companies filing interstate rates under Part 61.39 of FCC Title 47. Inherent in this methodology is the timing lag discussed above. On cross examination, ICC witness, Ms. Marshall, stated that she had only a general understanding of the FCC's ratemaking rules, but admitted in effect that under the FCC ratemaking methodology and the corresponding State mirroring requirement these timing differences will correct themselves. Transcript pp. 401-403.

The access rate reduction has begun to reduce the Company's intrastate access revenues and did so immediately upon filing on July 3, 2001. In Ms. Marshall's testimony, she does not dispute the fact that Gridley Telephone Company will experience a known and measurable reduction in state access revenues as a result of the July 3, 2001 filing. But she does propose to ignore it.

Since the effect of this known and measurable change has already begun to occur, the annual impact on state revenues due to the rate change must be subtracted from 2000 annual total operating revenues in order to accurately reflect the Company's going forward earnings level. While this higher level of revenue was available in year 2000 to subsidize the Company's need for universal service support, the Company has demonstrated and the Staff has not challenged the fact that this



revenue stream has been reduced. To ignore the effect of this change understates the Company's need for universal service support for the supported services.

The Company accepts the Staff's position that special access should not be on the list of supported services at this time. The Company does, however, dispute the argument of Staff that its pro forma adjustment for reduction in intrastate access revenues should be disallowed. Mr. Flesch testified that the Company is not requesting USF support for "special access" services.<sup>12</sup> Gridley Ex. 4.0, p. 6. The adjustment Ms. Marshall seeks to disallow is necessary to reflect the impact this state mandated revenue change has on the Company. Staff's proposed adjustment has the effect of reducing the Company's need by fictitiously showing a revenue stream that the Staff admits is going away. By ignoring this "real world" change in the state revenues of the Company, the Staff proposal overstates revenues the Company will actually receive and the Company's earnings. The Company's calculation of revenue deficiency in the amount of **\$514,219** should be the funded amount.

**E. Harrisonville Telephone Company**

The record shows that Harrisonville Telephone Company presently receives funding pursuant to the Commission's Twenty-Seventh Interim Order in Docket No. 83-0142 and the orders of the Commission in Docket No. 97-0621 and Docket No. 98-0679. IITA Ex. 2, Attachments 1 and 2. The record also shows that the Company's economic costs of providing services for which universal

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<sup>12</sup> See prior footnote discussing the Company's need for universal service support (without regard to Staff's special access issue) as shown by the Company's embedded cost study which separated out special access and all other non-supported services.

service support may be made available exceed the affordable rate for such services less federal universal service support received by the Company with respect to such services. IITA Ex. 2, Attachment 5. The record contains evidence designed to identify implicit subsidies in access charges. IITA Ex. 2, Attachment 6. The record also contains evidence to address the Commission's concern about the level of earnings by the small companies. The Company presented evidence to show that it is not overearning. Harrisonville Ex. 1, Schedule 1.01. This evidence also shows that the Company's requested amount of State universal service support will not cause it to be overearning. Id. Therefore, the Company is eligible and has a need for State universal service support under Section 13-301(d) of the Public Utilities Act.

The affordable rate for basic local exchange telecommunications service in the Company's service area is the Company's existing rate of \$25.62. IITA Ex. 4.0, Attachment 8. This amount includes all charges and taxes that a subscriber of the Company must pay in order to have access to basic local exchange service. For purposes of determining eligibility for State universal service support funding, the Company's affordable rate (including only the local charge and the state SLC) is \$19.18.<sup>13</sup> IITA Ex.2, Attachment 5, line 30. The Company's current rates are below the affordable rates proposed by the ICC Staff, Verizon and WorldCom, and above the affordable rates calculated using the methodologies presented by Harrisonville and the IITA. The affordable rate issue is addressed for all of the Companies, including Harrisonville, later in this Brief. It is the Company's position that its existing rates are the affordable rates.

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<sup>13</sup> This amount represents a weighted average rate.

The Company's costs of providing basic local exchange services or its "economic costs" are shown in three different ways in the record, and a fourth manner of looking at its costs based on an embedded cost analysis was offered but not admitted into the record. The testimony including the embedded cost analysis was accepted as an Offer of Proof. The Company's rate of return ("ROR") earnings analysis, which may be considered a "proxy" under the statute, shows a funding deficiency of \$1,064,529. Harrisonville Ex. 1, p. 6 & Schedule 1.01. The IITA has explained the inherent difficulties in accepting the results of the HAI model on an individual small company basis, and therefore has proposed using the weighted average cost for the combined group of small companies as a "proxy." IITA Ex. 2, pp. 13-15 and 44. The small companies as a group have economic costs exceeding their affordable rate and federal funding under the weighted average proxy cost approach. IITA Ex. 2, p. 46 and IITA Ex. 2, Attachment 5, line 57. If the HAI model results for the Company are considered on an individual basis, the evidence shows a need of \$3,465,018 for the Company. IITA Ex. 2, Attachment 5, line 30. The embedded cost analysis offered by the Company but not admitted shows a need of \$3,574,660. Harrisonville Ex. 3.0, p. 10 & Schedule 3.01 (O of P) and Harrisonville Ex. 5.0, p. 5 (O of P). Thus, the Company qualifies for State universal service support under each of the proposed methodologies in the record (and the embedded cost analysis which was offered but not admitted) for determining economic costs, eligibility and funding. Harrisonville's position on the correct interpretation of the undefined term "economic cost" in the statute and the correct method to use for determining economic costs, eligibility and funding is addressed later in this Brief.

The Company's federal universal service support received for the same or similar costs of

providing the supported services is identified and subtracted out of the Company's ROR analysis, the HAI analysis presented by IITA (whether considered in the aggregate with the group of small companies as a "proxy" or on an individual company basis) and the embedded cost analysis which was offered by the Company but not admitted. Harrisonville Ex. 1, Schedule 1.01, IITA Ex 2, Attachment 5, and Harrisonville Ex. 3, Schedule 3.01(O of P).

Harrisonville Telephone Company has shown a need for annual State universal service support in the amount of **\$1,064,529** based on a proper ROR earnings analysis. Harrisonville Ex. 1, Schedule 1.01 and IITA Ex. 4, Attachment 10, 2nd Revised, line 33. **The Company is requesting funding in this amount.** No party or ICC Staff witness challenged the ROR analysis presented by the Company,<sup>14</sup> and the Company's witness, Mr. Lee Whitcher, was not cross examined on the Company's ROR analysis. Based upon its ROR analysis and its affordable rate, the Company has a need for and qualifies for State universal service support in said amount.

**F. Home Telephone Company**

The record shows that Home Telephone Company presently receives funding pursuant to the Commission's Twenty-Seventh Interim Order in Docket No. 83-0142 and the orders of the Commission in Docket No. 97-0621 and Docket No. 98-0679. IITA Ex. 2, Attachments 1 and 2. The record also shows that the Company's economic costs of providing services for which universal service support may be made available exceed the affordable rate for such services less federal

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<sup>14</sup> There was a proposed change in the amount of funding for the Company proposed by the ICC Staff based on the amounts of federal universal support as discussed by ICC Staff witnesses Voss and Smith, however following rebuttal testimony by IITA witness Schoonmaker the Staff's proposed change was withdrawn. See ICC Staff Ex. 15.0, Schedule 15.19.

universal service support received by the Company with respect to such services. IITA Ex. 2, Attachment 5 and Home Ex. 2. The record contains evidence designed to identify implicit subsidies in access charges. IITA Ex. 2, Attachment 6. The record also contains evidence to address the Commission's concern about the level of earnings by the small companies. The Company presented evidence to show that it is not overearning. Home Ex. 1, Schedule 1.01. This evidence also shows that the Company's requested amount of State universal service support will not cause it to be overearning. Id. Therefore, the Company is eligible and has a need for State universal service support under Section 13-301(d) of the Public Utilities Act.

The affordable rates for basic local exchange telecommunications service in the Company's service area are the Company's existing residential rates of \$27.20 in town and \$27.73 in the rural areas.<sup>15</sup> Home Ex. 3.0 (Rebuttal Testimony of E. Schmidt), p. 3. This amount includes all charges (state SLC of \$12.45, federal End user Charge or SLC of 3.50 and touch tone charge of \$1.21) and all taxes, fees and surcharges that a subscriber of the Company must pay in order to have access to basic local exchange service. Id. For purposes of determining eligibility for State universal service support funding, the Company's affordable rate (including only the local charge, state SLC and touch tone charge) is \$21.75.<sup>16</sup> IITA Ex. 2, Attachment 5, line 32. The Company's current rate is below the affordable rates proposed by the ICC Staff, Verizon and Worldcom, and above the affordable rates calculated using the methodologies presented by Harrisonville and the IITA. The affordable

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<sup>15</sup> IITA calculated the weighted average rate for residential and business service for Home to be \$28.86. IITA Ex. 4, Attachment 8.

<sup>16</sup> This amount represents a weighted average rate.

rate issue is addressed for all of the Companies later in this Brief. It is the Company's position that its existing rates are the affordable rates.

The Company's costs of providing basic local exchange services or its "economic costs" are shown in three different ways in the record, and a fourth manner of looking at its costs based on an embedded cost analysis was offered but not admitted into the record. The testimony including the embedded cost analysis was accepted as an Offer of Proof. The Company's rate of return ("ROR") earnings analysis, which may be considered a "proxy" under the statute, shows a funding deficiency of \$633,541. Home Ex. 1, p. 5 & Schedule 1.01. The IITA has explained the inherent difficulties in accepting the results of the HAI model on an individual small company basis, and therefore has proposed using the weighted average cost for the combined group of small companies as a "proxy." IITA Ex. 2, pp. 13-15 and 44. The small companies as a group have economic costs exceeding their affordable rate and federal funding under the weighted average proxy cost approach. IITA Ex. 2, p. 46 and IITA Ex. 2, Attachment 5, line 57. With respect to the possible consideration of HAI results on a company specific basis, the company presented direct testimony of M. Petrouske and the results of an HAI run with additional company specific inputs. Home Ex. 2.0. If the HAI model results for the Company are considered on an individual basis, which is a position the Company does not advocate, the evidence shows a need of \$53,507 for the Company. Home Ex. 2.0, Schedule 2.01. The embedded cost analysis offered by the Company but not admitted shows a need of \$474,128. Home Ex. 4.0, p. 11 & Schedule 4.01 (O of P) and Home Ex. 4.0, p. 5 (O of P). Thus, the Company qualifies for State universal service support under each of the proposed methodologies in the record (and the embedded cost analysis which was offered but not admitted) for determining economic

costs, eligibility and funding. Home's position on the correct interpretation of the undefined term "economic cost" in the statute and the correct method to use for determining economic costs, eligibility and funding is addressed later in this Brief.

The Company's federal universal service support received for the same or similar costs of providing the supported services is identified and subtracted out of the Company's ROR analysis, the HAI analysis presented by IITA (whether considered in the aggregate with the group of small companies as a "proxy" as a whole or on an individual company basis) and the embedded cost analysis which was offered by the Company but not admitted. Home Ex. 1, Schedule 1.01, IITA Ex 2, Attachment 5, and Home Ex. 4, Schedule 4.01(O of P).

Home Telephone Company has shown a need for annual State universal service support in the amount of **\$633,541** based on a proper ROR earnings analysis. Home Ex. 1.0, p. 5 & Schedule 1.01, Home Ex. 3.0, p. 4 and IITA Ex. 4, Attachment 10, 2nd Revised, line 29. **The Company is requesting funding in this amount.** No party or ICC Staff witness challenged the ROR analysis presented by the Company,<sup>17</sup> and the Company's witness was not cross examined. Based upon its ROR analysis and its affordable rate, the Company has a need for and qualifies for State universal service support in said amount.

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<sup>17</sup> There was a proposed change in the amount of funding for the Company proposed by the ICC Staff based on the amounts of federal universal support as discussed by ICC Staff witnesses Voss and Smith, however following rebuttal testimony by IITA witness Schoonmaker the Staff's proposed change was withdrawn. See ICC Staff Ex. 16.0, Schedule 16.02.